

**REDACTED DECISION – DOCKET NUMBERS 11-223 C, 11-224 NFN, 11-225 –  
BY GEORGE V. PIPER, ADMINISTRATIVE LAW JUDGE - SUBMITTED FOR  
DECISION ON AUGUST 25, 2011 – ISSUED ON FEBRUARY 17, 2012**

**SYNOPSIS**

**TAX ADMINISTRATION -- DUTIES OF TAX COMMISSIONER --** It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W. Va. Code Ann. § 11-1-2 (West 2010).

**CONSUMERS SALES AND SERVICE TAX & SALES AND USE TAX -- DUTY TO COLLECT --** Article Fifteen of the West Virginia Tax Code imposes a general consumers sales and service tax, for the privilege of selling tangible personal property or custom software and for the privilege of furnishing certain selected services, and it is the duty of the vendor to collect the same. *See* W. Va. Code Ann. §§ 11-15-1 and 11-15-3 (West 2010).

**CONSUMERS SALES AND SERVICE TAX & SALES AND USE TAX -- FAILURE TO COLLECT --** If any vendor fails to collect the tax imposed by section three, article fifteen, the vendor shall be personally liable for the amount the vendor failed to collect. *See* W. Va. Code Ann. § 11-15-4a (West 2010).

**CONSUMERS SALES AND SERVICE TAX & SALES AND USE TAX -- PRESUMED TAXABLE --** “To prevent evasion, it is presumed that all sales and services are subject to the tax until the contrary is clearly established.” W. Va. Code Ann. § 11-15-6(b) (West 2010).

**CONSUMERS SALES AND SERVICE TAX & SALES AND USE TAX -- MAINTAINING TAX RECORDS --** “Every person doing business in the State of West Virginia . . . shall keep complete and accurate records as are necessary for the Tax Commissioner to determine the liability of each vendor or vendee for consumers sales and use tax purposes” W. Va. Code R. § 110-15-14a.1 (1993).

**CONSUMERS SALES AND SERVICE TAX & SALES AND USE TAX -- BEST INFORMATION AVAILABLE --** If, when auditing taxpayer records, said records are, “inadequate to accurately reflect the business operations of the taxpayer, the tax auditor will determine the best information available and will base the audit report on that information.” W. Va. Code R. § 110-15-14b.4 (1993).

**CONSUMERS SALES AND SERVICE TAX & SALES AND USE TAX -- BURDEN OF PROOF --** In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is on the Petitioner to show that any assessment of tax against it is erroneous, unlawful, void, or otherwise invalid. *See* W. Va. Code Ann. § 11-10A-10(e); W. Va. Code R. §§ 121-1-63.1 and 69.2 (2003).

**CONSUMERS SALES AND SERVICE TAX, SALES AND USE TAX & BUSINESS FRANCHISE/CORPORATE NET INCOME TAX -- BURDEN OF PROOF --**

Where an assessment is based on a methodology developed to estimate the amount of tax due, to satisfy its burden of proving that the assessment is erroneous, a taxpayer may not merely question the methodology of the assessment, but must provide credible evidence to show the actual amount of tax due.

**CONSUMERS SALES AND SERVICE TAX, SALES AND USE TAX & BUSINESS FRANCHISE/CORPORATE NET INCOME TAX --BURDEN OF PROOF NOT MET --**

The Petitioner failed to satisfy its burden of proof by reason of its failure to provide evidence to show the actual amount of its sales subject to the consumers sales and service tax and business franchise/corporate net income tax.

**FINAL DECISION**

A tax examiner with the Field Auditing Division (Division) of the West Virginia State Tax Commissioner's Office (Tax Commissioner or Respondent) conducted an audit of the books and records of the Petitioner. Thereafter, on June 5, 2011, the Director of this Division issued a consumers sales and service tax assessment against the Petitioner. The assessment was issued pursuant to the authorization of the State Tax Commissioner, under the provisions of Chapter 11, Articles 10 and 15 of the West Virginia Code. The assessment was for the period of January 1, 2008, through June 30, 2008, for tax in the amount of \$\_\_\_\_\_, interest in the amount of \$\_\_\_\_\_, computed through July 16, 2011, and additions to tax in the amount of \$\_\_\_\_\_, for a total assessed tax liability of \$\_\_\_\_\_. Written notice of this assessment was served on the Petitioner as required by law.

Also, on June 5, 2011, the Commissioner, by the Division, issued a sales and use tax assessment against the Petitioner, under the provisions of Chapter 11, Articles 10, 15 and 15A of the West Virginia Code, for the period of July 1, 2008, through March 31, 2011, for tax in the amount of \$\_\_\_\_\_, interest in the amount of \$\_\_\_\_\_, computed through July 16, 2011,

and additions to tax in the amount of \$\_\_\_\_\_ for a total assessed tax liability of \$\_\_\_\_\_. Written notice of this assessment was served on the Petitioner as required by law.

Also, on June 5, 2011, the Commissioner, by the Division, issued a business franchise/corporate net income tax assessment against the Petitioner, under the provisions of Chapter 11, Articles 10, 23 and 24 of the West Virginia Code, for the period of November 1, 2007, through October 31, 2010, for tax in the amount of \$\_\_\_\_\_, interest in the amount of \$\_\_\_\_\_, computed through July 16, 2011, and additions to tax in the amount of \$\_\_\_\_\_, for a total assessed tax liability of \$\_\_\_\_\_. Written notice of this assessment was served on the Petitioner as required by law.

Thereafter, by mail postmarked June 15, 2011, received on June 17, 2011, the Petitioner timely filed with this Tribunal, the West Virginia Office of Tax Appeals, a separate petition for reassessment for each assessment. *See* W. Va. Code Ann. §§ 11-10A-8(1); 11-10A-9 (West 2010).

Subsequently, notice of a hearing on the petitions was sent to the Petitioner, and a hearing was held in accordance with the provisions of West Virginia Code Section 11-10A-10.

### **FINDINGS OF FACTS**

1. In October 2010 two of Respondent's tax auditors travelled to New York City to do an audit of Petitioner's tax records which were in the sole possession of Petitioner's CPA firm. Respondent's tax auditors made return visits in December 2010, and May 2011.

2. Prior to the October 2010 visit the tax auditors requested that all daily guest checks be kept for their review. This request was again made before they returned in December 2010 and before their final visit in May 2011; however, none were kept until the audit was finally completed and the assessments issued.

3. On repeated occasions, when the tax auditors asked to see the past daily guest checks and cash register tapes they were informed that Petitioner did not keep guest checks (receipts) or cash register tapes because Petitioner did not have room to store those items.

4. During their visits to New York City the tax auditors were provided bank statements, monthly sales summary sheets, purchase invoices, W-2s and tax returns.

5. Petitioner's CPA requested that an adjustment should be made to Petitioner's cost of goods sold figure because some customers pay in cash in order to get a discount, but Petitioner did not have receipts to prove any such discount amount and Petitioner did not take credit cards during the audit period, so that request was denied.

6. Also, during the audit, it was revealed that the Petitioner's financial records did not correlate with Petitioner's own bank deposit statements. The records shown to the auditors indicated a certain level of sales; however, the bank statements indicated that over a million dollars in sales was never deposited or otherwise accounted for by the Petitioner.

7. Because Petitioner lacked sales receipts from the restaurant or other reliable back-up information, and because of discrepancies in the Petitioner's bookkeeping described above, the tax auditors received permission from the Tax Commissioner to conduct a surveillance of Petitioner's restaurant.

8. The first surveillance began on November 5, 2010, by a tax auditor sitting in the parking lot and recording the number of customers who entered the restaurant when it opened at 11:00 a.m., prior to his entering the building for lunch at 11:30 a.m., which lasted until 1:00 p.m. He kept a tip sheet of the number of customers who entered and either ate on the premises or took a takeout meal (55 lunch customers).

9. The second surveillance was conducted on November 19, 2010, from 11:00 a.m., until 5:00 p.m., when he recorded, from the parking lot, the number of customers entering the

restaurant, the time they entered and the time they left and who ate in and who did takeout (40 lunch customers).

10. The third surveillance was conducted on December 3, 2010, from 5:00 p.m., to 9:00 p.m., (55 dinner customers). Again, the surveillance recorded the number of customers who went in to eat and those who did takeout. During the surveillances he did not count customers who left the restaurant empty handed, but counted those who left the restaurant with food as takeout customers and those who stayed for at least twenty to thirty minutes as eat in customers. He noted in his surveys that Petitioner did not accept credit cards.

11. During the surveillance when the tax auditor ate a meal inside the restaurant, he noted that the cash register was used as a cash drawer, that nothing was entered into the cash drawer, and that the calculator next to the cash register was not used while he was in the restaurant.

12. Petitioner never produced any “z” tapes<sup>1</sup>, so there were no daily summaries that were ever provided to Respondent for review.

13. Having determined that cash sales were grossly underreported the tax auditors developed a methodology to calculate the correct amount using an average number of customers per day for lunch and dinner, based upon the tax auditor’s surveillance survey, multiplied by Petitioner’s buffet price for lunch and dinner (1/2 buffet price for children), with a fixed reduction because not all customers drank soda.

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<sup>1</sup> A “z” tape is a cash register tape that is normally run at the end of the day showing a summary of that day’s sales, sometimes broken down by category. It will show consumers sales and service tax collected, and if there were any “void sales” or “no sales,” and the amount of any void sales.

## **DISCUSSION**

The sole issue for determination is whether Petitioner has shown that the assessments were erroneous, unlawful, void or otherwise invalid. All taxpayers must comply with consumers sales and service and use tax regulation 110-15-14a.1 which states that, "Every person doing business in the State of West Virginia . . . shall keep complete and accurate records as are necessary for the Tax Commissioner to determine the liability of each vendor or vendee for consumers sales and use tax purposes." W. Va. Code R. § 110-15-14a.1 (1993). Further, "if records are inadequate to accurately reflect the business operations of the taxpayer the tax auditor will determine the best information available and will base the audit report on that information." W. Va. Code R. § 110-14b.4 (1993).

In this case Respondent's tax auditors testified that they made three visits to Petitioner's New York City CPA, with the understanding that he had all of the tax records, to do a complete audit. He had been instructed to keep all guest checks for their review; however none were kept until the audit was finally completed and the assessments issued. Further, they were informed on those three occasions that the Petitioner did not keep guest checks or cash register tapes because Petitioner did not have storage space for those items.

In this matter, the tax auditors had no complete and accurate records to determine the consumers sales and service tax and sales and use tax liability of the Petitioner. In fact, Petitioner's own financial records which were under the control of the New York City CPA did not even correlate with its bank statements. Or put another way, the Petitioner's own financial records, which it provided to the auditors, showed that one million of additional income was received but never deposited or otherwise accounted for by the Petitioner. The tax auditors also testified that Petitioner's New York City CPA asked them to adjust Petitioner's cost of goods sold to allow a discount when customers pay by cash or check, rather than pay using credit cards.

This request was rejected because Petitioner did not have any receipts to prove any such discounts and Petitioner did not take credit cards during the audit period.

Because Petitioner did not have complete and accurate records as required by consumers sales and use tax regulation 110-15-14a.1 the tax auditors testified that they determined that the only way to arrive at the best information available pursuant to West Virginia Code of State Rules Section 110-15-14b.4 was to have a surveillance survey conducted of Petitioner's restaurant. That was done over a period of a month, beginning on November 5, 2010, and ending December 3, 2010, which consisted of three visits, each lasting between two and six hours. During these surveillances a different tax auditor testified that he counted the number of customers who did take out and those who stayed in the restaurant to eat. On one occasion the same tax auditor entered the restaurant to eat lunch noting that when he paid his bill the cash register was used as a cash drawer, that nothing was entered into the cash drawer and that the calculator next to the cash register was not being used while he was in the restaurant. The total number of customers counted during the three surveillances, which covered both lunches and dinners, totaled 150 customers.

Based upon the survey conducted, the tax auditors who had traveled to New York City concluded that taxable sales were being grossly underreported for consumers sales and service tax and sales and use tax purposes which, of course, directly impacts the business franchise/corporate net income tax. Whereupon, a methodology was developed to calculate the correct amount of tax owed by using the average number of customers per day for lunch and dinner, based upon the tax auditor's surveillance survey, multiplied by Petitioner's buffet price for lunch and dinner (1/2 buffet price for children), with a fixed reduction because not all customers drank soda.

At the evidentiary hearing, Petitioner's representative testified that he recently had learned that Petitioner did indeed have 955 daily cash register tapes, covering 955 days which he wanted to introduce into evidence. The Petitioner's representative showed this evidence to Respondent's tax auditors several hours before the hearing but they refused to use them to alter the amount of tax owed..<sup>2</sup>

This Tribunal found Petitioner's argument concerning the existence and the probative value of these tapes to be unpersuasive for the following reasons. First, the tax auditors were informed on three separate occasions while in New York City that no such cash register tapes existed. This information came from the Petitioner's New York CPA. As such, the auditors believed this information to be reliable, because it came from the person doing Petitioner's taxes. Second, the existence of these records was never made known to this Tribunal during the many months preceding the evidentiary hearing, including status conferences and the prehearing conference.<sup>3</sup> Third, the auditors testified that they examined these purported register tapes and they appeared to be adding machine tapes. Finally, these purported cash register tapes did not coincide with any of the days during which the surveillances were conducted which makes their introduction even more suspect. As a result, this Tribunal determined that this evidence was of no probative value.

The Petitioner has the burden of proof. *See* W. Va. Code Ann. § 11-10A-10(e) (West 2010). Stated differently, the Tax Commissioner's assessment is presumed to be correct. Thus, when a taxpayer is assessed, it must prove that the assessment is incorrect. As part of its burden of proof, a Petitioner must present evidence to show the correct amount of tax it believe it owes.

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<sup>2</sup> The tax auditors testified that what the Petitioner claimed were cash register tapes appeared to be nothing more than adding machine tapes; none of which even covered the days during which the surveillances were conducted. It should be noted that Petitioner never did supply any guest checks to correlate with the purported cash register tapes, which further diminished their credibility.

<sup>3</sup> Petitioner's representative was instructed during a telephonic status conference that all such documentary evidence had to be submitted prior to the prehearing conference but none was submitted.



Thus, it is part of the Petitioner's burden of proof to show that it correctly reported its sales or, having incorrectly reported its sales, must show the correct amount and therefore provide some credible evidence to support its position. It is not sufficient for the taxpayer to keep inadequate records, and at the eleventh hour appear and state that it did, in fact, keep adequate records.<sup>4</sup> Because the Petitioner was required to present credible evidence to show the actual amount of its sales but never did so, its burden of proof was not met.

### CONCLUSIONS OF LAW

Based upon all the above it is **DETERMINED** that:

1. It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W. Va. Code Ann. § 11-1-2 (West 2010).
2. Article Fifteen of the West Virginia Tax Code imposes a general consumers sales and service tax, for the privilege of selling tangible personal property or custom software and for the privilege of furnishing certain selected services, and it is the duty of the vendor to collect the same. *See* W. Va. Code Ann. § 11-15-1 and § 11-15-3 (West 2010).
3. If any vendor fails to collect the tax imposed by section three, article fifteen, the vendor shall be personally liable for the amount the vendor failed to collect. *See* W. Va. Code Ann. § 11-15-4a (West 2010).
4. "To prevent evasion, it is presumed that all sales and services are subject to the tax until the contrary is clearly established." W. Va. Code Ann. § 11-15-6(b) (West 2010).

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<sup>4</sup> The Petitioner also made a halfhearted attempt to show that the Tax Commissioner counted too many customers during the survey. However, this attempt bordered on the ridiculous, such as suggesting that some of the people entering the restaurant did so to either use the bathroom, inquire about the use of credit cards, or most incredibly, to look for their children. Petitioner's only criticism about the manner in which the audit was conducted in New York City was that the tax auditors could not have done a good job because they did not speak Chinese. It should also be noted that the auditors testified that the Petitioner's New York City CPA spoke perfect English.

5. “Every person doing business in the State of West Virginia...shall keep complete and accurate records as are necessary for the Tax Commissioner to determine the liability of each vendor or vendee for consumer sales and use tax purposes.” W. Va. Code R. R. § 110-15-14a.1 (1993).

6. If, when auditing taxpayer records, said records are, “. . . inadequate to accurately reflect the business operations of the taxpayer, the tax auditor will determine the best information available and will base the audit report on that information.” W. Va. Code R. § 110-15-14b.4 (1993).

7. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is on the Petitioner to show that any assessment of tax against it is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code Ann. § 11-10A-10(e); W. Va. Code. R. §§ 121-1-63.1 and 69.2 (2003).

8. Where an assessment is based on a methodology developed to estimate the amount of tax due, to satisfy its burden of proving that the assessment is erroneous a taxpayer may not merely question the methodology of the assessment, but must provide credible evidence to show the actual amount of tax due.

9. The Petitioner failed to satisfy its burden of proof by reason of its failure to provide evidence to show the actual amount of its sales subject to the consumers sales and service tax, sales and use tax and business franchise/corporate net income tax.

### **DISPOSITION**

**WHEREFORE**, it is the **FINAL DECISION** of the West Virginia Office of Tax Appeals that the consumers sales and service tax assessment issued against the Petitioner for the period of January 1, 2008, through June 30, 2008, for tax in the amount of \$\_\_\_\_\_, interest in

the amount of \$\_\_\_\_\_, updated through July 16, 2011, and additions to tax in the amount of \$\_\_\_\_\_, totaling \$\_\_\_\_\_, should be and is hereby **AFFIRMED**.

Interest continues to accrue on this unpaid tax until this liability is fully paid.

It is also the **FINAL DECISION** of the West Virginia Office of Tax Appeals that the sales and use tax assessment issued against the Petitioner for the period of July 1, 2008, through March 31, 2011, for tax in the amount of \$\_\_\_\_\_, interest in the amount of \$\_\_\_\_\_, computed through July 16, 2011, and additions to tax in the amount of \$\_\_\_\_\_, totaling \$\_\_\_\_\_ should be and is hereby **AFFIRMED**.

Interest continues to accrue on the unpaid tax until this liability is fully paid.

It is also the **FINAL DECISION** of the West Virginia Office of Tax Appeals that the business franchise/corporate net income tax assessment issued against the Petitioner for the period of November 1, 2007, through October 31, 2010, for tax in the amount of \$\_\_\_\_\_, interest in the amount of \$\_\_\_\_\_, computed through July 16, 2011, and additions to tax in the amount of \$\_\_\_\_\_ totaling \$\_\_\_\_\_, should be and is hereby **AFFIRMED**.

Interest continues to accrue on this unpaid tax until this liability is fully paid.

**WEST VIRGINIA OFFICE OF TAX APPEALS**